



## **Multistate Tax Commission Memorandum**

States Working Together Since 1967 . . . To Preserve Federalism and Tax Fairness

To: Joan Wagnon, Chair  
Members of the Commission

From: Shirley Sicilian, General Counsel

Date: August 3, 2006

Subject: Proposed Model Reportable Transactions Statutes - Executive Committee Action,  
Bylaw 7 Survey Results and Possible Amendment

Attachment: Proposed Model Statute Showing Possible Amendments

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### **I. Executive Committee Action**

On June 16, 2005, the Multistate Tax Commission Executive Committee approved for public hearing the Proposed Model Reportable Transactions and Inconsistent Filing Positions Statute and the companion Proposed Model Tax Avoidance Transaction Voluntary Compliance Program Statute. Hearings were held in Washington, DC on September 27, 2005. A Preliminary Hearing Officer's Report was filed in November, 2005. The Uniformity Committee reviewed preliminary Hearing Officer recommendations at its March, 2006 meeting and members of the Committee indicated support. A Final Hearing Officer's Report was filed in May, 2006. At its May meeting, the Executive Committee voted to refer the two Proposals to the Full Commission, with amendments as recommended by the Hearing Officer and further amendments as recommended by the Committee.

### **II. Bylaw 7 Survey**

On June 15, 2006, Bylaw 7 Surveys regarding the proposed model statutes was sent to the Compact Member States. A majority of the affected Compact member states have responded affirmatively to the surveys, indicating that they would consider adoption of the draft proposals. Thus, the matters may be referred to the full Commission for a vote and possible adoption as a uniformity recommendation.

### **III. Possible Amendment**

At its May, 2006 meeting, the Executive Committee directed staff to work with interested parties to discuss a possible amendment to the Proposed Model Reportable Transaction and State Filing Position Statute, and to report back to the Full Commission so that it might consider making such an amendment prior to voting on the Proposal.

#### **A. Background**

The Proposed Model Reportable Transaction and State Filing Position Statute now before the Full Commission would require a taxpayer to, among other things, disclose its state filing positions in a “51 state spreadsheet.” As this provision was originally passed by the Uniformity Committee, it would have required taxpayers to identify any information that was reported to a state in a manner inconsistent with how the same information was reported to another state, and to disclose those as “inconsistent state filing positions.”

During the public comment period and at public hearing, extensive comments were received regarding the “inconsistent filing position” reporting requirement. Commenters characterized the proposal as vague, overbroad and burdensome. One commenter noted that the tax systems in the various states are not uniform to a degree that would support subjecting compliant taxpayers to the administrative burden of reviewing filings to determine inconsistencies, to penalties for failure to identify the inconsistencies, or to an increased burden of proof where there is an inconsistency.

The hearing officer recommended the requirement to disclose inconsistent filing positions be deleted and replaced with a requirement for the provision of a “51 state spreadsheet.” The “51 state spreadsheet” was an alternative recommendation of the original drafting group to the Uniformity Committee, based on the recommendation of the Corporate Income Tax Sheltering Work Group<sup>1</sup>, and would meet most, although not all, of the expressed concerns. The spreadsheet would allow auditors to compare a taxpayer's filing position in their state with the filing position taken in another state known to have comparable laws, with out requiring the taxpayer to make those comparisons.

This recommendation was reviewed, along with all other Hearing Officer recommendations, by the Uniformity Committee at its March, 2006 meeting. This particular issue was discussed and members of the Committee indicated support for the change. The Executive Committee then considered the recommendations at its May, 2006 meeting. At that meeting the Executive Committee heard public comment suggesting the move to a “51 state spreadsheet” was a move in the right direction, but did not go far enough. Some suggested that these provisions should simply be deleted. Others suggested this particular change was substantive enough to warrant further public hearings.

The Executive Committee approved the Hearing Officer’s recommended proposal with the “51 state spreadsheet” approach, and this is currently before the Full Commission. However, the Executive Committee suggested the Full Commission could consider further amendments to make the proposal more easily administrable. To this end, the Executive Committee asked staff to work with interested parties and determine if further amendments are possible. Staff and representatives of the Montana Department of Revenue, the Utah Department of Revenue and the California Franchise Tax Board<sup>2</sup> worked to produce a model spreadsheet and filing instructions (see attachment A and B). These

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<sup>1</sup> A proposal for a federal requirement for a 51-jurisdiction spreadsheet was also made by the Worldwide Unitary Taxation Working Group in 1984.

<sup>2</sup> State representatives included Bruce Johnson, UT; Frank Hales, UT; Dan Bucks, MT; Brian Staley, MT; Andrea Change, CA-FTB; Alfredo Ramirez, CA-FTB.

were circulated to representatives of Tax Executives Institute, the American Institute for Certified Public Accountants and the Council on State Taxation. Teleconference discussions with these parties were held on June 8, 2006. Additional input was later received from Tax Executives Institute. Based on all of this input, as well as internal discussions, staff drafted possible further amendments (see attachment C).

## **B. Discussion**

### **• *State Goals***

The states' goals are to compile in one document some very basic pieces of tax information that already exists on the returns the taxpayer files in the states in which it does business. The purposes of the compilation are:

1. To serve as a scoping tool to gain an understanding of how the taxpayer filed in each state and identify potentially inconsistent positions. It is anticipated that the spreadsheet coupled with the state and federal return will provide sufficient information to complete a comprehensive scope thereby reducing areas of inquiry.
2. To serve as a tool for narrowing audits so that they can be performed more quickly, or even bypassed altogether.
3. To foster an environment of greater transparency, and thus promote voluntary compliance.
4. To identify nowhere income and apportionment factors (e.g., differences in the treatment of an item of income as business vs. non-business, differences in the reported members of the unitary group, or sales not situated to any one state) to understand how the taxpayer reported in each state for the purpose of uniformity and our goal of minimizing duplicate or less than full apportionment of income among states.

### **• *Amendments to Achieve Those Goals with a Reasonable Administrative Burden***

Amendments are suggested to the Title of the Model Statute, section I and Section III. Only Section III contains substantive amendments. The amendments to the Title and to section I are conforming amendments.

Of the proposed amendments in Section III, most are simply changes in terminology to reflect the impact of the few substantive changes. To make our purposes better understood, we no longer ask for "disclosure of inconsistent positions on a 51 state spreadsheet." We ask instead for taxpayers to "file a compilation of state tax return data."

There are four substantive changes as follows:

- Delayed effective date. We recommend delaying the effective date so that the compilation would be required for tax years beginning on or after January 1, 2009. The purpose of the delay is to give taxpayers and software vendors time to

develop the software that will ease the administrative burden. Staff would commit to working with tax payers on a task force to identify the filing requirements so that programming could be developed. A resolution to that effect is before the Commission.

- Uniform filing format. The proposed amendments include a directive that the form for filing be consistent with the format developed and maintained for such filing by the Multistate Tax Commission (as developed by the task force mentioned above)
- Additional time for filing the compilation and providing data upon request. The spreadsheet was to be filed with and attached to the original and any amended returns. Under the amendments, the compilation of state tax return data would be filed within 180 days of the filing of the original federal income tax return and any amended [State] income tax returns exclusive of federal changes. In addition, the time for responding to a request for additional state information is increased from 30 days to 60 days.
- Delete presumption and increased burden of proof. Under the current proposal, the taxpayer is presumed liable for underpayments resulting from an inconsistent filing position. The presumption may be overcome, but to do so the taxpayer must meet a higher “clear and convincing” burden of proof. The proposed amendments would delete these provisions.

(Attachment A)

STATE	BUSINESS ENTITY NAME	FEIN	FILING METHOD	Total Income	Total Allocable Income	Total Apportionable Income	Income Apportionable To state	Income Allocable to state	Income subject to tax	PROPERTY			PAYROLL			SALES		
										Numerator	Denominator	Percentage	Numerator	Denominator	Percentage	Numerator	Denominator	Percentage
Alabama	XYZ Corp	12-3456789	d.															
	ABC Corp		d.															
Alaska																		
Arizona																		
Arkansas																		
California																		
Colorado																		
Connecticut																		
Delaware																		
D.C.																		
Florida																		
Georgia																		
Hawaii																		
Idaho																		
Illinois																		
Indiana																		
Iowa																		
Kansas			Filing method															
Kentucky			a. worldwide															
Louisiana			b. domestic/water's edge filing															
Maine			c. consolidated nexus															
Maryland			d. separate filing															
Massachusetts			e. other															
Michigan																		
Minnesota																		
Mississippi																		
Missouri																		
Montana																		
Nebraska																		
Nevada																		
New Hampshire																		
New Jersey																		
New Mexico																		
New York																		
North Carolina																		
North Dakota																		
Ohio																		
Oklahoma																		
Oregon																		
Pennsylvania																		
Rhode Island																		
South Carolina																		
South Dakota																		
Tennessee																		
Texas																		
Utah																		
Vermont																		
Virginia																		
Washington																		
West Virginia																		
Wisconsin																		
Wyoming																		

**(Attachment B)**

**- - FOR DISCUSSION PURPOSES ONLY**

**MTC Disclosure of Filing Position Instructions:**

In addition to completing the spreadsheet, please attach a copy of the following:

1. First four pages of the Consolidated Federal 1120 as filed with the Internal Revenue Service
2. Federal Form 851
3. Federal Schedule M-3, if required to be completed for federal purposes

**Spreadsheet Instructions:**

- A) State – list state where return is filed.
- B) Business Entity Name – name of entity with activity in state
- C) FEIN – Federal Identification Number of entity
- D) Filing Method – enter filing method used on return filed with state
- E) Total Income – Enter total income, before state adjustments, reported on the state return as filed. For combined reporting states this is the combined net income of the group.
- F) Total Allocable Income – enter the amount of non-business or allocable income deducted on the return as filed
- G) Total apportionable income – enter the amount of apportionable income reported on the return as filed.
- H) Income apportioned to state – enter the total amount of income apportioned to state (Column H times state's apportionment factor)
- I) Income Allocable to State – enter the amount of income determined to be directly allocable to state and reported on the return as filed
- J) Income Subject to Tax – Enter the amount of income subject to tax reported on the return as filed
- K) Property Numerator – If applicable, enter the property factor numerator reported on the return as filed.
- L) Property Denominator – If applicable, enter the property factor denominator reported on the return as filed.
- M) Property Factor Percentage – If applicable, Column L divided by Column M
- N) Payroll Numerator – If applicable, enter the payroll factor numerator reported on the return as filed.
- O) Payroll Denominator – If applicable, enter the payroll factor denominator reported on the return as filed.
- P) Payroll Factor Percentage – If applicable, Column O divided by Column P
- Q) Sales Numerator – If applicable, enter the sales factor numerator reported on the return as filed.
- R) Sales Denominator – If applicable, enter the sales factor denominator reported on the return as filed.
- S) Sales Factor Percentage – If applicable, Column R divided by Column S

(Attachment C)

**Multistate Tax Commission**

**Draft Model Uniform Statute on  
Disclosure of Reportable Transactions and  
State Filing Positions Compilation of State Tax Return Data**

**As Approved by Executive Committee May 11, 2006 and  
Submitted for Bylaw 7 Survey June 15, 2006  
*Showing Proposed Amendments***

**I. Definitions.**

**1. Reportable Transaction.** "Reportable transaction" means any transaction or arrangement with respect to which information is required to be included with a state return or statement because, as determined under regulations prescribed pursuant to this act, such transaction or arrangement is of a type which 1) the Director determines as having a potential for avoidance or evasion of the tax imposed by the [State income tax Act], whether through deduction or credit, the excludability or omission of any income, the manipulation of any allocation or apportionment rule, or the securing of any other tax benefit, and 2) is carried out through or invested in by at least one entity or person that is organized in this State, doing business in this State, deriving income from sources in this State, subject to [State Income Tax Act], or is otherwise subject to the jurisdiction of this State. A reportable transaction includes, but is not limited to, any transaction or arrangement described in U.S. Treasury Regulations Section 1.6011-4(b), a listed transaction as defined under Section I.2. and a non-economic substance transaction as defined under Section I.43. A "reportable transaction" does not include any transaction identified by the Director through notice, regulation, bulletin or other form of official Department guidance, as not constituting a tax avoidance transaction.

**2. Listed Transaction.** "Listed transaction" means a reportable transaction that is the same as, or substantially similar to, a transaction or arrangement specifically identified by the Director as a tax avoidance transaction through notice, regulation, bulletin or other form of official Department guidance. In addition, the term "listed transaction" includes any reportable transaction that is the same as, or substantially similar to, a transaction or arrangement specifically identified by the U.S. Secretary of Treasury as a tax avoidance transaction for purposes of Internal Revenue Code Section 6011.

~~**3. Inconsistent Filing Position.** "Inconsistent filing position" means the reporting or reflecting of information on any return filed for [State] income tax purposes in a manner inconsistent with the manner in which the same or similar information was reported or reflected on any return filed by the same taxpayer, or by a member of a unitary group of which the same taxpayer is a member, in another state with respect to a tax on or measured by net income for the same tax year.~~

**43. Non-Economic Substance Transaction.** “Non-economic substance transaction” means any transaction or arrangement that lacks economic substance, as defined by [State or federal] law; including a transaction or arrangement in which an entity is disregarded as lacking a valid nontax [State] business purpose.

**54. Tax Shelter.** “Tax shelter” means a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of [State] or Federal income tax.

**65. Disqualified Opinion.** “Disqualified opinion” means an opinion that:

A. is based on unreasonable factual or legal assumptions (including assumptions as to future events);

B. unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person;

C. does not identify and consider all relevant facts, or

D. fails to meet any other requirement as prescribed by either the U.S. Secretary of the Treasury for purposes of Internal Revenue Code Section 6664(d)(3)(B)(iii) or the Director.

**76. Disqualified Tax Advisor.** “Disqualified tax advisor” means a tax advisor that meets any of the following conditions:

A. is a material advisor and participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of Internal Revenue Code Sections 267(b) or 707(b)(1)) to any person who so participates;

B. is compensated directly or indirectly by a material advisor with respect to the transaction;

C. has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained; or

D. as determined under regulations prescribed by either the Secretary of the Treasury for purposes of Internal Revenue Code Section 6664(d)(3)(B)(ii) or the Director, has a disqualifying financial interest with respect to the transaction.

**87. Material Advisor.** “Material advisor” means any person who:

A. provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and

B. directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the U.S. Secretary of Treasury for purposes of Internal Revenue Code Section 6111(b)(1)(A)) for such advice or assistance. For purposes of this section, the threshold amount is

i. \$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and

ii. \$250,000 in any other case.

**98. Gross Valuation Overstatement.** “Gross Valuation Overstatement” means any statement as to the value of any property or services if:



A. the value so stated exceeds 200 percent of the amount determined to be the correct valuation, and

B. the value of such property or services is directly related to the amount of any deduction allowable under [State] or federal income tax, or credit allowable under [State] income tax, to any participant.

## **II. Taxpayer Responsibility for Disclosure of Reportable Transactions; Penalties; Waiver; Extension of Statute of Limitations.**

### **1. Disclosure of Reportable Transactions Required.**

**A. Disclosure Required.** For each tax year in which a taxpayer, a member of a federal consolidated group of which a taxpayer is a member[, or a member of a combined group of which a taxpayer is a member,] has participated in a reportable transaction, including a listed transaction, such taxpayer is required to disclose such transaction as provided in Section II.1. B., below. In addition, for each tax year in which a taxpayer, a member of a federal consolidated group of which a taxpayer is a member[, or a member of a combined group of which a taxpayer is a member,] is required to make a disclosure statement under Treasury Regulations Section 1.6011-4 with respect to a reportable transaction, including a listed transaction, in which the taxpayer participated; such taxpayer shall file a copy of such disclosure with the Department as provided in Section II.1.B., below.

**B. Time and Manner of Disclosure.** Reportable transactions, including listed transactions, shall be disclosed in the manner prescribed in Treasury regulations Section 1.6011-4 and Department rules and regulations. With respect to a federal listed transaction entered into after February 28, 2000, but before December 31, [year Act is adopted], disclosure shall be made on or before the due date of, and attached to, the taxpayer's original and any amended [State] income tax return for tax year [the year of this Act] and to the original and any amended [State] income tax return for any later tax year which reflects a reduction in tax resulting from such listed transaction, including a loss, deduction or credit resulting from a reportable transaction which is being carried forward or back. With respect to a reportable transaction, including a state or federal listed transaction, entered into after December 31, [year Act is adopted], disclosure shall be attached to the taxpayer's original and any amended [State] income tax return for the tax year during which the transaction was entered into and to the original and any amended [State] income tax return for any later tax year which reflects a reduction in tax resulting from such reportable or listed transaction, including a loss, deduction or credit which is being carried forward or back and which resulted from such transaction. Disclosure of a reportable transaction entered into after February 28, 2000 shall also be attached to any amended [State] income tax return filed after December 31, [year Act is adopted] where such filing reflects a determination by the Internal Revenue Service of the federal tax treatment of a reportable transaction.

**C. Effective Date.** The provisions of this Section II.1. shall apply to any reportable transaction entered into after February 28, 2000, for any tax year or years for which

the transaction remains undisclosed, and for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of 60 days after the effective date of this Act.

## **2. Penalties Related to Failure to Disclose a Reportable Transaction.**

### **A. Imposition and Amount.**

i. Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under Section II.1. to be included with such return or statement shall pay a penalty, in addition to any other penalty imposed, in the amount determined under Section II.2.A.ii., below.

ii. (a) Except as provided in Section II.2.A.ii.(b), below, the amount of the penalty imposed under Section II.2.A.i., above, shall be [\$X (\$10,000 in IRC). In setting this amount, states should be cognizant that penalty may apply in other states for the same infraction.] in the case of a natural person, and [\$X (\$50,000 in IRC) Note: penalty may apply in other states for the same infraction.] in any other case.

(b) The amount of penalty under Section II.2.A.i. with respect to a listed transaction shall be [\$X (\$100,000 in IRC) Note: penalty may apply in other states for the same infraction.] in the case of a natural person, and [\$X (\$200,000 in IRC) Note: penalty may apply in other states for the same infraction.] in any other case.

**B. Assessment Date.** Penalty imposed under Section II.2.A.i. shall be deemed assessed on the due date of the [State] income tax return upon or attached to which disclosure of the reportable transaction was required pursuant to Section II.1. of this Act and Department rules and regulations.

### **C. Waiver.**

i. The Director, in his or her sole discretion, may waive or abate all or any portion of any penalty imposed by this Section II.2. with respect to any violation if:

(a) the violation is with respect to a reportable transaction other than a listed transaction, and

(b) rescinding the penalty would promote compliance with the requirements of [State Income Tax Act] and effective tax administration.

ii. Notwithstanding any other law or rule of law, any determination under this Section II.2.C. may not be reviewed in any judicial proceeding.

**D. Effective Date.** Penalty imposed under this Section II.2. shall apply to any failure to disclose any listed transaction entered into after February 28, 2000, or any other reportable transaction entered into after the effective date of this act, as required by Section II.1., for any tax year or years for which the transaction remains undisclosed, and for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of 60 days after the effective date of this Act.

### **3. Penalties Related to Understatement of Tax Resulting from a Reportable Transaction.**

#### **A. Understatement Penalty.**

##### **i. Imposition and Amount.**

(a) If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of such understatement.

(b) For purposes of this Section II.3.A.,

(1) The term “reportable transaction understatement” means the sum of:

(A) product of:

(i) the highest rate of tax imposed by [Section on state corporate income tax rates]; and

(ii) the amount of the increase (if any) in [State] taxable income which results from a difference between the proper tax treatment of an item to which Section II.1.A. applies and the taxpayer’s treatment of such item as shown on the taxpayer’s return of tax, including an amended return provided such amended return is filed prior to the date the taxpayer is first contacted by the Department regarding the examination of the tax year for which such amended return is filed; The amount of the increase in [State] taxable income for a particular tax year includes the restatement for another tax year to which a loss or deduction is carried forward or carried back that is attributable to the reportable transaction for that year in which the carry forward or carry back of the loss or deduction applies; and

(B) the amount of the decrease (if any) in the aggregate amount of credits which results from a difference between the taxpayers treatment of an item to which this section applies (as shown on the taxpayer’s return of tax) and the proper tax treatment of such item.

For purposes of Section II.3.A.i.(b)(1)(A), any reduction of the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would be allowed for such year, shall be treated as an increase in taxable income.

(2) This Section II.3.A. shall apply to any item which is attributable to:

(A) any listed transaction, and

(B) any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of federal or [State] income tax.

(c) Section II.3.A.i.(a), above, shall be applied by substituting “30 percent” for “20 percent” with respect to the portion of any reportable transaction understatement with respect to which the requirements of section II.1 are not met.

(d) Except as provided in regulations, in no event shall any tax treatment included with an amendment or supplement to a return of tax be taken into account in determining the amount of any reportable transaction understatement if amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by the Director regarding the examination of the return or such other date as is specified by the Director.

**ii. Assessment Date.** Penalty imposed under this Section II.3.A. shall be deemed assessed on the due date of the [State] income tax return which shows the understatement of tax resulting from a reportable transaction to which such penalty relates.

## **B. Interest Penalty.**

### **i. 50% Interest Penalty Prior to Contact; Imposition and Amount.**

For any amended return filed after [end of voluntary compliance or date of enactment if no voluntary compliance program] and before the taxpayer is contacted by the Internal Revenue Service or the Department regarding a reportable transaction, there shall be added to any reportable transaction understatement, as determined under Section II.3.A.i.(b)(1), a penalty, in addition to any other applicable penalties, equal to 50% of the interest assessed under Section [Interest Section] on such reportable transaction understatement for the period beginning on the last date prescribed by law for the payment of such tax (determined without regard to extensions) and ending on the date of payment.

**ii. 100% Interest Penalty After Contact; Imposition and Amount.** If the taxpayer has been contacted by the Internal Revenue Service or the Department regarding a reportable transaction, there shall be added to any reportable transaction understatement, as determined under Section II.3.A.i.(b)(1), a penalty, in addition to any other applicable penalties, equal to 100% of the interest assessed under Section [Interest Section] on such reportable transaction understatement for the period beginning on the last date prescribed by law for the payment of such tax (determined without regard to extensions) and ending on the date of the notice of proposed assessment is mailed.

**iii. Assessment Date.** Penalty imposed under this Section II.3.B. shall be deemed assessed upon the assessment of the interest by which such penalty is calculated and shall be collected and paid in the same manner as such interest.

## **C. Waiver.**

**i.** Except as provided in Section II.3.C.ii. below, the Director, in his or her sole discretion, may waive or abate all or any portion of any penalty imposed by Section II. 3. with respect to any portion of a reportable transaction understate-

ment if it is shown that the taxpayer had reasonable cause for such portion and acted in good faith with respect to such portion. Notwithstanding any other law or rule of law, any determination by the Director under this subdivision may not be reviewed in any judicial proceeding.

ii. Section II.3.C.i. shall not apply to any reportable transaction under-statement unless:

(a) the relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with all requirements of Section II.1. and Department rules and regulations. A taxpayer failing to fully disclose shall be treated as meeting the requirements of this Section II.3.C.ii.(a) if the penalty for that failure to disclose was waived pursuant to Section II.2.C.;

(b) there is or was substantial authority for such treatment; and

(c) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment. A taxpayer shall be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief:

(1) is based on the facts and law that exist at the time the return which includes such tax treatment is filed, and

(2) relates solely to the taxpayer's chances of success on the merits of such treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit, or such treatment will be resolved through settlement if it is raised; and

(3) does not rely upon the opinion of a disqualified tax advisor or on a disqualified opinion.

**D. Effective Date.** Penalty imposed under Section II.3. shall apply to any under-statement of tax resulting from a listed transaction entered into after February 28, 2000, or from any other reportable transaction enter into after the effective date of this act, in any tax year or years for which the statute of limitations on assessment, taking into account the extension provided under Section II.4., has not expired as of the effective date of this Act.

#### **4. Extension of Statute of Limitations for Assessments Associated with Non-Disclosure of a Reportable Transaction.**

If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction as required under Section II.1., the time for assessment of any tax imposed by [State Income Tax Act] with respect to such transaction shall not expire before the date which is 1 year after the earlier of (A) the date on which the Director is furnished the information so required, or (B) the date that a taxpayer meets the requirements of Section IV.2. with respect to a request by the Director under Section IV.2.B. relating to such transaction with respect to such taxpayer.

### **III. Taxpayer Responsibility for ~~Disclosure of Filing Positions~~Filing Compilation of State Tax Return Data; Penalties; Waiver; Extension of Statute of Limitations; Presumption and Burden of Proof.**

**1. Disclosure of Filing Positions in other Income Tax States**  
**Compilation and Filing of State Tax Return Data.**

**A. ~~Disclosure~~ Compilation and Filing Required.** A taxpayer that conducts business activity in this state and one or more other states or is a member of a combined reporting group that conducts business activity in this state and one or more other states, shall ~~disclose, in the form and manner prescribed by the Director, the filing position taken in~~ compile the information described by Section III.1.C. and file, in the form and manner required by Section III.1.D, state tax return data as reported on its tax returns filed in this and all other income tax states with respect to whether a filing is required, business income, nonbusiness income, apportionment, and combined reporting.

**B. Definitions.** For purposes of Section III of this Act:

- i. "Business activity" means any activity conducted in a state that gives rise to gross income or an expense reflected in the taxpayer's federal income tax return or income tax return of any state, or the use (or availability for use) of property in the state.
- ii. "State" means a state of the United States, and includes the District of Columbia .
- iii. "Income tax state" means any state that imposes a tax on, according to, or measured by income.
- iv. "Business income" means the total income (or loss) subject to apportionment.
- v. "Nonbusiness income" means income (or loss) subject to allocation to a specific state or states.
- vi. "Apportionment percentage" means the percentage formula used to assign a portion of the business income of the taxpayer or the combined reporting group of which the taxpayer is a member to an income tax state.
- vii. "Apportionment factor" means any component ratio used in the apportionment percentage used to apportion business income, such as a property factor, payroll factor, or a sales factor.
- viii. "Allocation" means assignment of income to one or more income tax states by means other than apportionment.
- ix. "Combined reporting" means a method of determining business income and apportionment that takes into account the business income and apportionment factors of more than a single corporation, and for purposes of this section includes a consolidated return.

**C. Information Required to Be ~~Disclosed~~ Compiled and Filed.** For each income tax state in which a taxpayer or a member of a combined reporting group of which a taxpayer is a member has business activity, the following information shall be ~~disclosed~~ compiled and filed:

- i. Whether the taxpayer filed in that state.
- ii. The business income of the taxpayer, or of the taxpayer's combined reporting group, reported to that state.

iii. The total nonbusiness income of the taxpayer, or the total nonbusiness income of each member of the taxpayer's combined reporting group.

iv. The total nonbusiness income of the taxpayer, or the total nonbusiness income of each member of the taxpayer's combined reporting group, allocable to that state.

v. For each of the apportionment factors used to determine the apportionment percentage, the dollar amount of the numerator and the denominator of the ratio used in that factor.

vi. The apportionment percentage used to apportion income subject to taxation in that state.

vii. The dollar amount of business income apportioned to that state.

viii. For those states that use combined reporting to apportion income, for each combined reporting group of which the taxpayer is a member, a list of all corporations whose business income was included in business income of the combined reporting group.

ix. Such other information relating to the determination of business income, nonbusiness income, or the apportionment or allocation of that income as the Director, by regulation, shall require.

**D. Time and Manner of ~~Disclosure~~Filing.** ~~Disclosures-~~The compilation of state tax return data required by Section III.1. shall be filed ~~with, and attached to,~~ within 180 days of the filing of the original federal income tax return and any amended [State] income tax returns ~~exclusive of federal changes for any tax year to which the requirements apply,~~ in the form and manner required by the Director ~~and consistent with the format developed and maintained for such filing by the Multistate Tax Commission pursuant to Multistate Tax Commission Resolution 06-01.~~

**E. Effective Date.** The provisions of this Section III.1. are effective for ~~tax years ending on or after the effective date of this Act.~~ tax years beginning on and after January 1, 2009.

## **2. Retention and Provision of Records.**

**A. Retention and Provision of Records Required.** A taxpayer shall retain a copy of its filings of [State] schedule [apportionment schedules identifier] and of the equivalent schedule filed by the taxpayer [or a member of the taxpayer's combined reporting group] in such other state or states in which the taxpayer [or the taxpayer's combined reporting group] conducted business activity; and shall, within ~~30-60~~ days of written request, or within such additional time as the Director may grant upon written request for extension, provide a copy of such schedules to the Director. Information required to be retained under this Section III.2. shall be retained for that period of time during which the taxpayers' income tax liability to this state for that tax year may be subject to adjustment, including all periods in which additional income taxes or penalties may be assessed, or during

which a protest, appeal or lawsuit is pending with respect to [State] income tax, ~~but not less than ten years from the due date or extended due date of the return.~~

**B. Effective Date.** The provisions of this Section III.2. ~~shall be effective [upon the date of enactment of this act] and~~ shall apply to information associated with any return due on or after the date two years before the enactment of this Act. Provided however, during the course of an audit investigation, the Director may, following the effective date of this Act, require provision of such information as may be in possession of the taxpayer [or a member of the taxpayer's combined reporting group] for any tax year for which the statute of limitations on assessment has not expired.

**3. Penalties Related to Failure to ~~Disclose~~File, Retain or Provide Information Regarding ~~Filing Positions~~State Tax Return Data.**

**A. Imposition and Amount.**

i. A taxpayer that fails to ~~fully disclose~~file, retain or provide any information with respect to ~~filing positions~~state tax return data as required by Section III.1 and 2. of this Act and Department rules and regulation, shall be subject to penalty in an amount determined under Section III.3.A.ii., in addition to any other applicable penalties.

ii. (a) For failure to file a ~~disclosure of filing positions~~compilation of state tax return data as required pursuant to Section III.1., the amount of the penalty shall be the greater of \$10,000 or 0.25 percent of the amount of net income properly apportioned and allocated to this State.

(b) For failure to provide information required to be retained under Section III.2. within ~~30~~60 days of a request by the Director, or within such additional time as the Director may allow by extension, there shall be assessed a penalty in the amount of \$[X]. An additional penalty in the amount of \$[Y] shall be assessed with respect to each additional 30 days thereafter during which the information is not provided. A taxpayer that has not retained the information required under Section III. 1. C., shall, after submitting an affidavit that such information does not exist, be subject to a penalty in the amount of \$[Z] in lieu of additional 30 day penalties.

**B. Assessment Date.** Penalty imposed under Section III.3.A.ii.(a) shall be deemed assessed on the due date of the ~~[State] income tax return upon or attached to which disclosure of filing positions was filing~~ required pursuant to Section III.1 and Department rules and regulations. The penalty imposed under Section III.3.A.ii.(b) shall be deemed assessed on the 30<sup>th</sup> day following a request by the director, and , if applicable, every 30 days thereafter for which taxpayer fails to provide the information required to be retained pursuant to Section III.2 .

**C. Waiver.**

i. The Director, in his or her sole discretion, may waive or abate all or any portion of any penalty imposed by this Section III.3. with respect to any violation



if rescinding the penalty would promote compliance with the requirements of this Act and effective tax administration.

ii. Notwithstanding any other law or rule of law, any determination by the Director under this subdivision may not be reviewed in any judicial proceeding.

**D. Effective Date.** Penalty imposed under this Section III.3. shall apply to any failure to ~~disclose~~file, retain or provide any information ~~regarding a filing position, as~~ required pursuant to Section III.1. or 2., with respect to any tax year ending on or after the effective date of this Act.

#### **4. Extension of Statute of Limitations for Assessments Associated with Non-Disclosure Filing.**

If a taxpayer fails to ~~fully disclose~~file all information required under Section III.1 of this Act and Department rules and regulations with respect to ~~filing positions~~state tax return data, an assessment and notice of deficiency may be issued not later than [twice the standard SOL] after the ~~tax return or statement~~ was due or filed, whichever is later, ~~upon or attached with respect~~ to which such ~~disclosure~~filing of state tax return data was required. Extension of the statute of limitations under this Section III.4. is limited to extension for purpose of assessment of a tax deficiency, penalty and interest resulting from an application of the proper tax treatment with respect to ~~a filing position~~information that was not ~~disclosed~~filed pursuant to Section III.1. and that ~~is an inconsistent filing position as defined in Section I.3.~~was not reported in the same or similar manner in a tax return filed with another state.

#### **~~5. Presumption and Burden of Proof.~~**

~~A taxpayer shall be presumed to be liable for any underpayment of tax properly assessed by the Director, where such underpayment resulted from a filing position, which is an inconsistent filing position, as defined in Section I.3., with respect to a position taken in another state with substantially similar law. The taxpayer may overcome such presumption by submission of clear and convincing evidence to the contrary.~~

### **IV. Material Advisor Responsibility for Disclosure of Reportable Transactions and Maintenance of Advisee Lists; Penalties; Waiver.**

#### **1. Material Advisor Responsibility for Disclosure of Reportable Transactions.**

A. Each material advisor with respect to any reportable transaction shall make a return in such form as the Director may prescribe setting forth -

- i. information identifying and describing the transaction,
- ii. information describing any potential tax benefits expected to result from the transaction, and
- iii. such other information as the Director may prescribe.

In addition, each material advisor who is required to disclose a reportable transaction pursuant to Internal Revenue Code Section 6111 shall file a copy of such disclosure with the Department. Such return and disclosure shall be filed not later than the date specified by the Director.

- B.** The Director may prescribe regulations which provide -
- i.** that only 1 person shall be required to meet the requirements of Section IV.1.A. in cases in which 2 or more persons would otherwise be required to meet such requirements, and.
  - ii.** exemptions from the requirements of this section.

**2. Material Advisor Responsibility for Maintenance of Reportable Transaction Advisee List.**

**A.** Each material advisor with respect to any reportable transaction shall, whether or not required to file a return under Section IV.1., maintain a list identifying each [State] taxpayer[, member of a combined group of a [State] taxpayer] and member of a consolidated return of a [State] taxpayer with respect to whom such advisor acted as a material advisor with respect to such transaction. The list required under this Section IV.2.A. shall include the same information, and shall be maintained in the same form and manner, as required under Internal Revenue Code Section 6112, Treasury Regulations Section 301.6112-1, and any additional information or maintenance requirements as the Director may by regulation require.

- B.** Any person required to maintain a list under Section IV.2.A. -
- i.** shall make such list available to the Director upon written request by the Director, and
  - ii.** except as otherwise provided by the Director by regulation, shall retain any information which is required to be included on such list for 7 years.

**C.** The Director may, by regulation, provide that in cases in which 2 or more persons are required under Section IV.2.A. to maintain the same list (or portion thereof), only 1 person shall be required to maintain such list (or portion).

**3. Penalty for Failure to Disclose a Reportable Transaction or to Maintain Advisee List.**

**A. Imposition and Amount.**

**i. Penalty for Failure to Disclose a Reportable Transaction.**

**(a)** If a person who is required to file a return or disclosure under Section IV.1 with respect to any reportable transaction (1) fails to file such return or disclosure on or before the date prescribed therefore, or (2) files false or incomplete information with the Director with respect to such transaction, such person shall pay a penalty with respect to such return or disclosure in the amount determined under Section IV.3.A.(b) and (c).

**(b)** Except as provided in Section IV.3.A.i.(c), below, the penalty imposed under Section IV.3.A.i.(a) with respect to any failure shall be [\$X (\$50,000 under IRC)].

**(c)** The penalty imposed under Section IV.3.A.i. with respect to any listed transaction shall be an amount equal to the greater of (1) [\$X (\$200,000 under IRC) Note: penalty may apply in other states for the same infraction.], or (2) [X% (50% under IRC) Note: penalty may apply in other

states for the same infraction.]of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return and, if applicable, disclosure is filed under Section IV.1. Section IV.3.A.i.(c)(2) shall be applied by substituting “[Y% (75 % under IRC) Note: penalty may apply in other states for the same infraction.]” for “[X% (50 % under IRC)]” in the case of an intentional failure or act described in Section IV.3.A.i.(a).

**ii. Penalty for Failure to Maintain Advisee Lists.** If any person who is required to maintain a list under Section IV.2. fails to make such list available upon written request to the Director in accordance with Section IV.2.B. within 20 business days after the date of such request, such person shall pay a penalty of [\$X (\$10,000 under IRC)] for each day of such failure after such 20th day.

**iii.** Each of the penalties imposed by Section IV.3.A. is in addition to any other applicable penalties.

#### **B. Waiver.**

**i.** The Director, in his or her sole discretion, may waive all or any portion of penalty imposed under this Section IV.3:

**(a)** with respect to any violation of Section IV.1. if:

**(1)** the violation is with respect to a reportable transaction other than a listed transaction, and

**(2)** waiver of the penalty would promote compliance with the requirements of [State Income Tax Act] and effective tax administration.

**(b)** with respect to any violation of Section IV.2 if on any day such violation is due to reasonable cause

**ii.** Notwithstanding any other law or rule of law, any determination by the Director under this Section IV.3.B. may not be reviewed in any judicial proceeding.

#### **4. Effective Date.**

**A.** The provisions of this Section IV. shall apply to reportable transactions, other than listed transactions, with respect to which material aid, assistance, or advice referred to in section I.8. is provided after the date of the enactment of this Act.

**B.** The provisions of this Section IV. shall apply to listed transactions with respect to which material aid, assistance, or advice referred to in section I.8 is provided and which were entered into on or after December 31, 2001, that become listed transactions at any time. Reporting required under section IV.1 and 2. shall be furnished to the Director on or before the later of:

**i.** 60 days after entering into the transaction;

**ii.** 60 days after the transaction becomes a listed transaction; or

**iii.** the effective date of this act.

### **V. Tax Shelters**

#### **1. Penalty for Promotion of Tax Shelters.**

**A. Imposition and Amount.** Any person who

- i.
    - (a) organizes or assists in the organization of
      - (1) a partnership or other entity,
      - (2) any investment plan or arrangement, or
      - (3) any other plan or arrangement, or
    - (b) participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement referred to in Section V.1.A.i.(a) and
  - ii. makes or furnishes or causes another person to make or furnish in connection with such organization or sale -
    - (a) a statement with respect to the allowability of any deduction or credit, the excludability of any income, the manipulation of any allocation or apportionment rule, or the securing of any other tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or
    - (b) a gross valuation overstatement as to any material matter,
- shall pay, with respect to each activity described in Section V.1.A.i.(a) and in addition to any other penalty provided by law, a penalty equal to the [\$X (\$1,000 under IRC) Note: penalty may apply in other states for the same infraction.] or, if the person establishes that it is lesser, [X% (100% under the IRC) Note: penalty may apply in other states for the same infraction.] of the gross income derived or to be derived by such person from such activity. For purposes of the preceding sentence, activities described in Section V.1.A.i.(a) with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in Section V.1.A.i.(b) shall be so treated.

Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a statement described in Section V.1.A.ii.(a), the amount of the penalty shall be equal to [X% (50 % under the IRC) Note: penalty may apply in other states for the same infraction.] of the gross income derived or to be derived from such activity by the person on which the penalty is imposed.

**B. Waiver.** The Director, in his or her sole discretion, may waive all or any part of the penalty provided by Section V.A. with respect to any gross valuation overstatement on a showing that there was a reasonable basis for the valuation and that such valuation was made in good faith. Notwithstanding any other law or rule of law, any determination by the Director under this Section V.1.B. may not be reviewed in any judicial proceeding.

**2. Tax Shelter Exception to Confidentiality Privileges Relating to Taxpayer Communications.** No privilege of confidentiality shall apply to any written communication which is:

- A. between a tax practitioner and
  - i. any person,
  - ii. any director, officer, employee, agent, or representative of the person, or
  - iii. any other person holding a capital or profits interest in the person; and
- B. in connection with the promotion of the direct or indirect participation of the person in any tax shelter.

**3. Effective Date.** The provisions of this Section V. shall apply to activities after the date of the enactment of this Act.

## **VI. Injunction of Certain Conduct Related to Reportable Transactions and Tax Shelters.**

**1. Authority to Seek Injunction.** A civil action in the name of the State to enjoin any person from further engaging in specified conduct may be commenced at the request of the Director. Any action under this Section VI. shall be brought in [State District Court, county of DOR] The court may exercise its jurisdiction over such action separate and apart from any other action brought by the State against such person.

**2. Adjudication and Decree.** In any action under Section VI., if the court finds

- A. that the person has engaged in any specified conduct, and
- B. that injunctive relief is appropriate to prevent recurrence of such conduct; the court may enjoin such person from engaging in such conduct or in any other activity subject to penalty under this Act.

**3. Specified Conduct.** For purposes of this Section VI., the term “specified conduct” means any action, or failure to take action, which is

- A. subject to penalty under this Act, or
- B. in violation of any requirement under regulations issued pursuant to this Act.

## **Multistate Tax Commission**

### **Draft Model Uniform Statute for Tax Avoidance Transaction Voluntary Compliance Program**

*As Approved by Executive Committee May 11, 2006 and  
Submitted for Bylaw 7 Survey June 15, 2006*

#### **Section 1. Definitions.**

##### **A. Eligible taxpayer.**

i. The Tax Avoidance Transaction Voluntary Compliance Program applies to any taxpayer who, during the period from [Program start date] to [Program start date plus X months], does both of the following:

(a) files an amended [State] tax return for each tax year for which the taxpayer has previously filed a [State] tax return using a tax avoidance transaction to underreport the taxpayer's [State] income tax liability, reporting the total [State] net income and tax for such tax year computed without regard to any tax avoidance transactions and without regard to any other adjustments that are unrelated to tax avoidance transactions; and

(b) makes full payment of the entire amount of [State] income tax and interest due for such tax year that is attributable to the use of the tax avoidance transaction.

ii. Nothing in this section prohibits a taxpayer from filing a separate amended return with respect to adjustments unrelated to any tax avoidance transaction.

**B. Tax avoidance transaction.** A transaction, plan or arrangement devised for the principal purpose of avoiding federal or [state] income tax. Tax avoidance transactions include but are not limited to "reportable transactions," as defined in Section I.1. of the [RT and IFP Act], including "listed transactions," as defined in Section I.2. of the [RT and IFP Disclosure Act].

#### **Section 2. Tax Avoidance Transaction Voluntary Compliance Program.**

**A. In general.** There is hereby established a Tax Avoidance Transaction Voluntary Compliance Program (Program) for eligible taxpayers subject to tax under the [State Income Tax Act], as provided in this Act. The Program shall be developed and administered by the Department of Revenue (Department). The Program shall be conducted from [Program start date] to [Program start date plus X months] and shall apply to tax liabilities attributable to the use of tax avoidance transactions for tax years beginning before January 1, [more than 6 months before program start date]. The Department shall adopt rules, issue forms and instructions, and take such other action as it deems necessary to implement the provisions of this Act.

**B. Election.** An eligible taxpayer may elect to participate in the Program with respect to any tax year to which this Act applies under either Section 2.B.i. or Section 2.B.ii. The election shall be made for all tax years for which the taxpayer will participate and a separate election for different tax years, or for different transactions in different tax years, is not allowed. Such election shall be made in the form and manner prescribed by the Department, and, once made, shall be irrevocable.

**i. Voluntary compliance without appeal.** If an eligible taxpayer elects to participate under this Section 2.B.i., then:

(a) The Department shall waive or abate all penalty applicable to the underreporting or underpayment of [State] income tax attributable to the use of tax avoidance transactions for such tax years for which the taxpayer voluntarily complies, including penalty imposed under [the RT and IFP Act];

(b) except as otherwise provided in this Act, the Department shall not seek criminal prosecution against the taxpayer for such tax year, underreporting and underpayment with respect to tax avoidance transactions for which the taxpayer voluntarily complies;

(c) no penalty may be waived or abated under this Act if the penalty imposed relates to an amount of [State] income tax assessed or paid prior to [Program start date]; and

(d) the taxpayer may not file a claim for credit or refund with respect to the tax avoidance transactions for such tax year or for any amounts paid under this Act.

**ii. Voluntary compliance with appeal.** If an eligible taxpayer elects to participate under this Section 2.B.ii., then:

(a) the Department shall waive or abate any penalty imposed under [the RT and IFP Act] with respect to disclosure of tax avoidance transactions and underpayment of [State] income tax resulting from the use of tax avoidance transactions for any tax years for which the taxpayer voluntarily complies, but shall not waive accuracy related penalties as imposed prior to [date of enactment of RT and IFP Act];

(b) except as otherwise provided in this Act, the Department shall not seek criminal prosecution against the taxpayer for such tax year underreporting and underpayment with respect to tax avoidance transactions for which the taxpayer voluntarily complies;

(c) no penalty may be waived or abated under this Act if the penalty imposed relates to an amount of [State] income tax assessed or paid prior to [Program start date];

(d) The fact a taxpayer participated in the Program shall not be considered evidence the taxpayer engaged in a tax avoidance transaction;

(e) Any penalties which are not waived or abated shall be deemed assessed upon the due date of the return (determined without regard to extensions) upon which such amount should have been paid; and

(f) The taxpayer may file a claim for credit or refund as provided in the [State] Income Tax Act with respect to such tax year. Notwithstanding [Section

on deemed denials], the taxpayer may not file [an appeal] until after either of the following:

(1) the department issues a [final determination] with respect to the transactions at issue, or

(2) the earlier of (A) the date which is 180 days after the date of a final determination by the Internal Revenue Service with respect to the transactions at issue, or (B) the date that is [X years, where X = the number of years in the State's standard SOL] after the date the claim for refund was filed or one year after full payment of all [State] income tax, including penalty and interest. Section [section on administrative deemed denials] shall not apply to claims filed under this section.

**C. Installment payment agreement.** The Department may enter into an installment payment agreement in lieu of the full payment required under Section 1.A. Any installment payment agreement authorized by this subsection shall include interest on the unpaid amount at the rate prescribed by [regular interest provisions]. Failure by the taxpayer to fully comply with the terms of the installment payment agreement shall render the waiver of penalties null and void, and the total amount of tax, interest, and all penalties shall be immediately due and payable.

**D. Amended returns; unpaid amounts.** After [Program end date], the Department may issue a deficiency assessment upon an amended return filed pursuant to Section 1.A., impose penalties, or initiate criminal action under this part with respect to the difference between the amount shown on that return and the correct amount of tax, and the penalty relief under this Act shall not apply to any portion of the underpayment attributable to a tax avoidance transaction not paid to the State.

**E. Correspondence from the Department.** Any correspondence mailed by the Department to a taxpayer at the taxpayer's last known address outlining the Program established under this Act constitutes a "contact" for purposes of Sections II.3. of the [RT and IFP Act].

**F. Taxpayer Cooperation.** In addition to any other authority to examine returns, for the purpose of improving state tax administration, the Department may inquire into the facts and circumstances related to the use of tax avoidance transactions to underreport the tax liabilities for which a taxpayer has participated in the voluntary compliance initiative under this Act. Taxpayers shall cooperate fully with inquiries described in this Section 2.F. Failure by a taxpayer to fully cooperate in an inquiry described in this Section 2.F. shall render the waiver of penalties under this Act null and void and the taxpayer may be assessed any penalties that may apply.